

June 3, 2011

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington DC 20551

RE: Docket No. R-1409: Availability of Funds and Collection of Checks

Dear Ms. Johnson:

The Software & Information Industry Association (SIIA) submits the following comments in support of the Federal Reserve Board's (Board) above mentioned proposal on Regulation CC. In particular we support the Board's proposed clarifications of warranties and liabilities in connection with electronically-created items.

SIIA is the principal trade association for the software and digital content industries. SIIA provides global services in government relations, business development, corporate education and intellectual property protection to the leading companies that are setting the pace for the digital age. SIIA members include software and technology companies that provide payment processing services to individuals, merchants and financial institutions. They contribute to innovation and efficiency in the electronic payments marketplace by developing new payment applications and processing capabilities. These efficiency-enhancing innovations rely on electronic processing of information that is only impeded by traditional requirements for paper origination and authentication. If mobile payment applications and devices, for example, were required to produce paper verification of transactions at the point of sale, the speed, flexibility and convenience of this new electronic payment service would be lost. Regulatory flexibility is needed to unleash the forces of innovation.

For this reason, the amendments in the Board's proposal are significant to advancing check processing in the 21st Century. The Board's proposal takes into account the value that electronically-created items play in the customer and merchant marketplace. We support the Board's proposal to clarify the presence of certain liabilities and warranties for banks that transfer and receive such electronic items, even when they are not derived from paper.

The Board's proposal clarification applies to the processing of electronically-created items. These are items where an electronic image of a "check" is created, but a check never existed in paper. Some electronically-created items bear an electronic version of a signature. These

signature-bearing items are in electronic form, but they have not been generated by taking images of signed paper checks. They might be generated directly by electronic means such as when a customer signs a digital check via a software application on a mobile phone. As the Board notes, depository banks often cannot distinguish between these electronically-created items and electronic items that have been generated by a paper check. The Board proposes in Section 229.34(e) to apply to these electronically-created items the same warranties that apply to electronic items that have been created from a paper original. Thus, for example, the depository bank would warrant the accuracy of the information in the electronic image as if it had been derived from a paper check. SIIA supports these changes.

The Board is also proposing clarifications in the area of electronically-created items that do not bear an electronic version of a signature. Merchants and others regularly generate remotely-created checks where the customer is not present. This can occur over the telephone, on mobile devices, or via personal computer. The customer verbally or electronically authorizes the transaction and the merchant or processor creates a paper check, which has no signature, but instead has language indicating that the customer has authorized the creation of this check. Current warranty and liability rules require that depository banks that submit remotely created checks for payment warrant that the transaction is authorized by a person on whose account the item is drawn.

As the Board's proposal notes, depository banks forward for collection electronically-created items that appear to be remotely created checks, even though they are not derived from an original paper check. These banks, and the payor banks to which they are forwarded, cannot distinguish these electronically-created items from remotely created checks that are derived from paper originals. The Board therefore proposes to clarify that the same warranties and liabilities are assigned in the case of these electronically-created items as in the case of remotely created checks derived from paper. Thus, a depository bank would warrant that the electronic item that appears to be derived from a remotely created paper check has been authorized by the account holder and the paying bank receiving such an item would receive this warranty.

The premise behind this assignment of liabilities, in connection with remotely created checks, is that the depository bank is in a good position to prevent the introduction of unauthorized remotely created checks into the check collection process. This assignment of liabilities thereby creates an economic incentive for depository banks to perform the requisite due diligence on their customers. It allows the payor's bank to file a claim for reimbursement with the depository bank when the remotely created check has not been authorized by the account holder.

SIIA agrees with this assignment of liabilities and the premise underlying it. We also support the Board's proposed clarification in the case of electronically-created items. We see no reason to depart from this policy simply because the items in question have been electronically created, rather than generated from a paper original.

The Board also asks for comment on whether "in the future" it should apply other protections under Part C of Regulation CC to an electronically-created item, as if the item were a check.

Such a change would result, for example, in the paying bank to which the item is presented being subject to the regulation's expeditious-return requirement. SIIA can see no reason not to extend complete protections to electronically-created items and urges the Board not to wait until some unspecified time in the future to adopt such a requirement in the current proceeding.

Uses for Remotely Created Checks

Remotely created checks are not created by the account holder's bank. Instead, they are typically created by a payee, such as a merchant or credit card company, pursuant to instructions from the account holder. The account holder does not sign a remotely created check and the check itself does not bear a signature or the appearance of a signature. Typically, the remotely created check bears language indicating that the account holder has authorized the transaction and the printed or typed name of the account holder.

A recent report from an analyst at the Federal Reserve Bank of Atlanta describes the process of electronically-created items that resemble remotely created checks:

“Like traditional checks, remotely created checks can also be processed electronically by converting the paper check into an electronic file that is acceptable to image-exchange networks.²² But, unlike a traditional check, which is signed in paper form by the drawer before the check is image captured and converted into an “electronic item,” an electronic remotely created check (one never printed) can still be presented for payment using an electronic template, and nevertheless be sent forward for clearing in a format indistinguishable from files of images captured from paper checks. The payee still obtains the requisite account information and purported authorization from the account holder, but in this instance, a paper check is never presented for processing. Instead, an electronic image of a check is created, bearing a legend referencing authorization by the account holder. Typically, a payee contracts with a third party processing company to create the electronic remotely created check.”

The report notes that in recent years the use of these electronically-created items “has increasing.” This growth in the use of these electronically-created items supports the need for the clarification that the Board is proposing in connection with the warranties and liabilities associated with these items.

The report also states that the most common uses of remotely created checks include:

- (1) pre-authorized drafts, where for example, a consumer approves a payment of its insurance policy and the company issues an unsigned draft for the amount;
- (2) ACH administrative returns, where the ACH item is returned because the information originally provided from the MICR line cannot be properly processed and the merchant resubmits the ACH item as an unsigned draft;
- (3) telephone purchases, typically, where telemarketers call selling products or services to companies or individuals, and the telemarketer requests information from the consumer about its bank account for the purposes of obtaining payment;
- (4) depository transfer checks, instances where companies initiate transfer payments between their accounts, some of which may be between different banks;
- (5) return item fees, created by merchants to cover fees

for returned checks; and (6) bill payment, where the consumer authorizes a creditor such as a credit card company to create a remotely created check in order to timely pay a bill that would otherwise be late if paid with a traditional paper check.

NACHA has also listed several examples of important uses of remotely created checks:

- **“Same-Day Availability**

When a consumer negotiates a contract such as an insurance policy over the telephone, he or she may authorize either an ACH TEL entry or an RCC to pay the initial premium. However, if the consumer wishes to make the policy effective on the day of the conversation, the insurance provider will likely ask the consumer to authorize an RCC. The insurance company can deposit the RCC and receive same-day availability of the funds; whereas if a TEL debit is used, the insurance company is credited on the effective date of the TEL debit to the consumer, thereby delaying the date on which the policy takes effect by a day or two.

- **Recurring Telephone-Initiated Debits**

Merchants, insurance companies, and debt collectors all need the ability to accept recurring payments over the telephone. For example, some merchants who offer payment plans find it convenient to set up recurring debits over the phone. When they set up the plan with their customer, they obtain a single authorization for a series of recurring debits. The *Rules* do not allow the TEL application to be used for recurring debits based on a single authorization obtained over the telephone. Similarly, insurance companies also want to be able to set up recurring payments to collect monthly insurance premiums. For a collection agency to use the TEL application, a collector would have to make a call for each payment, greatly reducing the efficiency of the collection process. As with recurring debits for bills or purchases, agencies that conduct legitimate collection activities over the telephone often negotiate payment options with debtors. A repayment option may include a payment plan spread over weeks or months. These collectors prefer to set up a recurring date on which to deposit an RCC rather than schedule a call to get a new authorization for each subsequent ACH payment.

- **Collection of NSF Fees**

Retailers often use RCCs to collect NSF fees on returned checks. They do this in accordance with notices posted at the point of checkout. Notices that are appropriately worded and prominently displayed satisfy notification requirements and support a legitimate use of RCCs. The *Rules* require that ACH debits to collect NSF fees be authorized in a writing that is signed or similarly authenticated. This takes valuable time at the point-of-sale where efficiency can be measured in seconds. The extra time necessary to obtain a signed authorization makes using an ACH debit less efficient for collecting NSF fees at the point-of-sale.”

As this listing indicates, remotely created checks are used today in the marketplace for a variety of reasons, the majority of which are to resolve issues so that merchants receive payment via check when they are unable to do so under the typical automated clearing house (ACH) system.

Remotely created checks are used to resolve ACH administrative items. Administrative items are items that are returned through the ACH system in general as either “Unable to Locate/Invalid Account.” The vast majority of these items are returned due to no fault of the account holder, but instead could be a variety of reasons (1) incorrectly parsed magnetic ink character recognition (MICR) (2) MICR substitution errors (3) incorrect MICR to ACH conversion. It is widely used industry practice to research the item, obtain the original MICR and resubmit these items through as Remotely Created Checks.

Additionally, remotely created checks can be used when: (1) banks do not accept ACH (2) checks with MICR’s include the Auxiliary On-U’s Field and (3) checks go above certain dollar limits set by the ACH rules.

Lastly, remotely created checks are used to process exception items that cannot be processed through image clearing. In some instances, the actual image of the check is not up to standards to be able to present through image clearing. In those cases, it is beneficial to create a remotely created check in order to clear the item.

Value of Remotely Created Checks

The proposed regulation clarifies the liabilities and warranties associated with electronically-created remotely created checks. In support of the Board’s proposal we would like to highlight the value that remotely created checks provide to both the merchants and the consumers (the account holders). Remotely created checks enable merchants to offer another payment option to their customer, an option that actually may be cheaper than typical payment methods and save the merchant money. Additionally, the use of checks would reduce the amount of returned items that a merchant will have to absorb potentially as bad debt and can reduce fraud associated with longer clearing times on paper checks. In general, electronic checks, whether cleared through ACH, remotely created checks or image clearing, clear faster than original paper items that have to be deposited to the bank.

A number of benefits also exist for the consumers, the account holders. There are more payment options for the consumers, providing an electronic payment option for those that do not have credit cards. Most importantly, there will be efficient settlement so that the consumer will not experience problems of returned checks and with the Board’s proposal, companies will no longer need to print a paper remotely created checks, but just create a virtual remotely created checks – thereby, eliminating the risk of duplicate postings.

Positive Effect on Innovation

We are seeing much innovation in the area of alternative payments, particularly in mobile payments. Consumers, particularly smart phone users, are rapidly accepting new alternative ways to make and receive payments over their phone. Credit cards are expensive to process, so alternative payment methods are increasingly using settlement against the customer’s checking account. With the ability to utilize electronic remotely created checks and settle through image

exchange merchants can offer innovative, alternative payment methods and account holders would receive the same protections as they do with paper checks.

Additional Recommendations

The Board requests recommendations on whether it should, in the future, include electronically created checks under Subpart C. We agree. We recommend that electronically-created items that resemble remotely created checks be covered under Subpart C of Reg CC. This would make it clear that these items are subject to the expeditious return requirements in Subpart C. Technology advances very quickly, and to include these items under the expeditious return requirements would increase the potential for new bank products and payment system improvements. We do not agree that the Board should include these items “in the future,” given these potential benefits. However, if the Board does decide to wait on this inclusion, we recommend that the Board should actively monitor how remotely created checks are returned under ACH rules or merchant agreements.

Conclusion

Enhancing the use of remotely created checks by clarifying the liabilities and warranties associated with electronically-created items that resemble remotely created checks and making clear that the expeditious return requirements apply to these items, increases the efficiency of the financial services system and decreases the amount of risk associated with check processing. As such, we recommend that you include these items among the paperless items associated with Regulation CC.

We look forward to working with you as you move forward with this proposal. Please feel free to contact us if you have any questions.

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